SUPPLEMENTAL

COUNCIL AGENDA: 11/8/11
ITEM: 6.1

CITY OF
SAN JOSE
CAPITAL OF SILICON VALLEY

Memorandum

TO: HONORABLE MAYOR AND COUNCIL

FROM: William F. Sherry, A.A.E.

SUBJECT: SEE BELOW

DATE: November 4, 2011

Approved

Date 11/4/11

SUPPLEMENTAL

SUBJECT: IMPLEMENTATION OF A PER DAY RENTAL CAR CUSTOMER FACILITY CHARGE AT THE AIRPORT

REASON FOR SUPPLEMENTAL

The Council will consider establishing a per day rental car customer facility fee on November 8, 2011. The report prepared by staff is thorough and meets the state's requirements for conducting a public hearing to change from a per contract to a per day customer facility charge rate structure. However, staff believes the staff report may have generated questions that could not be fully addressed in the report. Accordingly, the purpose of the supplemental information below is to: 1) provide additional information that will clarify specific questions that may have been generated by the staff report; and 2) provide a more complete context for the issue and staff's recommendation. The supplemental information is presented in a question-and-answer format.

DISCUSSION

1. What is a Customer Facility Charge?

A Customer Facility Charge (CFC) is a fee required by an airport to be collected to assist in paying for the cost of financing, designing, and constructing rental car facilities and the capital and operating costs of common-use transportation systems to transport rental car customers between airport terminals and rental car facilities.

2. Who sets the CFC rate charged to customers?

Governing bodies of airports set the rate within maximum rate ceilings established by the State of California.

3. What is the current rate for CFCs?

The current maximum rate is $10 per rental car contract. However, since January 1, 2011, airports now have the option to implement a CFC at $6.00 per day for a maximum of five days. The rate can be increased to $7.50 per day (for a maximum of five days) beginning on January 1, 2014, and can be increased to $9.00 per day beginning January 1, 2017, (for a maximum of five days) until the indebtedness is paid off.

4. Why is the Airport now pursuing a per day CFC?

As result of the national recession, the reduction in passenger activity and the reduction in rental car contracts over the past three years, the amount of projected $10 per contract CFC revenue has dropped significantly. As a result, the rental car companies are paying costs that cannot be sustained over the long term. Implementing a per day CFC rate will restore a sustainable facility rents for the rental car companies over the term of the bond.

5. How much have CFC revenues dropped and how much has the gap grown between the CFC revenue collected and debt service on the ConRac since the rental car agreements were signed in 2007?

When the rental car companies signed their agreements in 2007 and 2008, they were expected to pay facility rent to cover a $145,000,000 gap between the amount of CFC projected to be collected and the debt service costs of the ConRac over the projected 30-year term of the financing. However, as a result of the recession, the Airport experienced reductions in the number of flights and a decline in air passenger activity that was reflected in a decline in rental car customer activity – and the related collection of CFC revenue. As a result of the decline in rental car customer activity, the amount of facility rent needed by the rental car companies to cover the gap grew by 283%, nearly tripling the facility rents the rental car companies needed to pay. This development prompted the rental car companies to ask the Airport to consider implementing a per day CFC rate structure shortly after the passage of the authorizing legislation (SB 1192).

6. Why is the City Council now being asked to approve an increase in the per day CFC rate that won't take effect until January 2014? Why not ask for the approval closer to 2014?

To maintain relatively consistent facility rent payment schedule for the rental car companies, an increase in the CFC rate from $6.00 to $7.50 is incorporated into the debt service structure of the upcoming bond issue. The increase in the CFC rate is needed to accommodate the larger principal sum payments due on the bonds in the later years of debt service. Without the increase to $7.50 in 2014, the facility rent paid by the rental car companies to cover the debt service is projected to grow significantly as the payment schedule progresses.

The State Controller's Office took an aggregate view of the CFC revenue needed to cover the costs for the ConRac and substantiated that even with the $7.50 rate increase, the amount of CFC revenue collected is not projected to exceed the reasonable costs of the ConRac.

7. What happens if rental car activity picks up and the Airport takes in more in CFC revenue than anticipated in any given year?

The collection of CFC revenue must be viewed in aggregate and not on a year-by-year basis. While CFC revenues could be higher than expected in any given year over the term of the bonds, staff does not anticipate that the per day CFC revenues collected in aggregate will exceed the total costs of financing, designing, and constructing the ConRac over the term of the bonds. In the event CFC revenues should exceed what is projected in any given year, since CFCs can only be used to cover specific eligible costs (the financing, design, and construction of the rental car facility and the operating and capital costs of the common-use transportation system), the additional revenue could be used to pay down the bond indebtedness sooner and, *perhaps*, offset the facility rent otherwise due from the rental car companies for the following year. The additional revenues could also be used to pay for the common-use transportation costs. However, only the common-use transportation costs associated with transporting customers from Terminal A are eligible CFC expenses. The CFC rate may need to be re-adjusted so that only customers coming from Terminal A pay for transportation costs as part of their CFC rate.

8. Is the CFC applied to satellite rental car operations off Airport property?

No. Under the City's CFC resolution and the terms of the Rental Car Agreements, the CFC only applies to customers who rent vehicles at the Airport.

9. Can the Airport continue to collect the per day CFC after the ConRac debt service is paid in full?

No. Authorization to collect the CFC (per contract or per day) ends when the bonds used for financing the ConRac are paid.

10. Is the Airport concerned about the per day CFC rate discouraging customers from renting cars on-Airport?

This important question was considered as part of the June 2011 analysis conducted for the Airport by Ricondo & Associates, an independent airport consultant. On the question of a per day CFC discouraging customers from renting cars, the report states:

"Based on analysis of historical rental car activity at the Airport in relation to prior increases in the cost of renting a car at the Airport (including but not limited to the increase in the CFC from $5 to $10 per transaction in January 2008), the City's plan to begin collecting a $6.00 CFC per transaction day in September 2011 and a $7.50 CFC per transaction day (subject to a five-day maximum) beginning January 2014 is not expected to have a significant impact on rental car activity at the Airport."

11. Isn't there any other way to raise the additional revenue needed to cover the debt service on the ConRac than imposing a higher fee on rental car customers?

No. There are only three possible sources to pay the debt service on the ConRac: 1) the rental car companies; 2) the rental car customers; and 3) the Airport. The rental car companies wanted a ConRac on the Airport for the convenience of their customers and rental car customers appreciate the convenience of having the ConRac conveniently located. It is therefore appropriate and fair that the cost of the debt service be allocated between parties that receive the most direct benefit from the ConRac's operation: the rental car companies and their customers.

The Airport would be obligated to pay the debt service on the ConRac if the rental car companies moved off the Airport and the Airport could no longer collect CFCs. In such event, the Airport would seek other tenants or uses for the ConRac (e.g. public parking), but would remain responsible for the debt service on the ConRac. The Airport would have to incorporate the additional costs into Airport operating budget. To the extent that revenue generated from alternative uses are not sufficient to cover the debt service and overall expenses could not be reduced, the CPE (cost per enplaned passenger) would increase and impact the Airport's overall competitiveness for air service and passengers.

12. The new rate takes effect December 1, 2011. Why is it taking effect so quickly?

The December 1, 2011, implementation date allows the increased revenues to begin to be generated to pay the first debt service payment on the upcoming bond issue.

13. Does the December 1 date allow for sufficient rental customer notification?

The rental car companies are prepared for the December 1, 2011, implementation date. Several rental car companies, in anticipation of the rate increases, have begun notifying customers making car rental reservations about the potential change in the CFC rate structure beginning December 1, 2011.

14. What factors could impact rental car facility rent?

The amount of facility rent the rental car companies pay in any given year will largely reflect the degree of rental car activity that year. For example, over the past year rental car activity has increased at a rate significantly greater than the increase in passenger activity at the Airport. As a result, more CFC revenue has been collected. In addition, interest rates have declined over the last seven months which would reduce the facility rent the rental car companies must pay. Interest rates may continue to fluctuate until the bonds are sold. A change in the interest rates will have a direct impact on the debt service and the rental car facility rent. To the extent that customer activity rises and bond interest rates remain low, the amount of facility rent the rental car companies will pay to cover the costs of the ConRac will decrease. However, in years when the activity level fails to meet expectations, the amount of facility rents paid by the rental car companies will rise. When the bonds are sold, the interest rates will be set. However, activity may fluctuate over the term of the bonds. As mentioned above, in the event that CFC revenues should exceed what is projected in any given year, the additional revenue could be used to pay down the bond indebtedness sooner or be applied to pay for common-use transportation costs.

15. If rental car activity has increased recently, does the Airport still need a $6 per day CFC? Does the Airport still need approval now for a $7.50 per day CFC?

Yes because the State Controller's Office review substantiated that the aggregate of CFC revenue projected to be collected over the term of the bonds, including at the $6.00 per day rate and the increase to $7.50 per day, will *not* exceed the total eligible CFC costs of the rental car ConRac and the common-use transportation system. To the extent more revenue than anticipated is generated in any given year, it could be used to pay down the indebtedness on the bonds sooner and/or fund the transportation costs.

16. The SCO observed that the interest earned on the debt service reserve fund for the ConRac should go to pay down the debt instead of into the Airport's general fund. Airport staff disagreed. Why?

The Airport's decision to issue General Airport Revenue Bonds (GARBs) instead of a special facility bonds significantly reduces the financing costs of the ConRac. The Airport's financial advisor estimated the cost savings of issuing a GARB to be in excess of *$60,000,000,* depending on market conditions at the time of the bond sale. Because the GARB is backed by general Airport revenues, the interest earnings on the GARB debt service reserve fund are considered general Airport revenue under the terms of the Airport Master Trust and should therefore flow to the General Airport Revenue Fund. The interest earnings would follow the specific fund/principal only if the Airport were issuing special facility bonds to fund the ConRac, rather than GARBs.

17. What is the percentage of the debt service on the ConRac the rental car companies will pay with the proposed per day CFC compared to: 1) when the rental car agreement was signed in 2007? and 2) when the CFC revenues dropped as a result of the recession?

At the time the agreements were signed in 2007/2008, the rental car companies were scheduled to pay 23% of the ConRac debt service (plus transportation costs). When the per transaction CFC revenue dropped 2008-2010 as a result of the recession, the rental car companies' share of the debt service increased to about 60%. Depending on the bond term and interest rates when the bonds are sold, and based on current activity projections, the rental car companies are projected to pay up to 8% of the debt service over the term of the bonds with the per day CFC revenues covering the balance.

/s/
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Director of Aviation

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